

Report on  
Market Conduct Examination

of

Fireman's Fund Insurance Company  
American Automobile Insurance Company  
The American Insurance Company  
Associated Indemnity Corporation  
National Surety Corporation

Novato, California

by Representatives of the  
North Carolina Department of Insurance

as of

April 24, 2014

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Raleigh, North Carolina  
April 24, 2014

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Honorable Commissioners and Honorable Directors:

Pursuant to your instructions and in accordance with the provisions of North Carolina General Statute (NCGS) 58-2-131 through 58-2-134, a compliance examination has been made of the market conduct activities of

**Fireman's Fund Insurance Company (NAIC #21873)**  
**American Automobile Insurance Company (NAIC #21849)**  
**The American Insurance Company (NAIC #21857)**  
**Associated Indemnity Corporation (NAIC #21865)**  
**National Surety Corporation (NAIC #21881)**

NAIC Exam Tracking System Exam Number: NC299-M25  
Novato, California

hereinafter generally referred to as the Companies, at the North Carolina Department of Insurance (Department) office located at 11 S. Boylan Avenue, Raleigh, North Carolina. A report thereon is respectfully submitted.

## **FOREWORD**

This examination reflects the North Carolina insurance activities of Fireman's Fund Insurance Company, American Automobile Insurance Company, The American Insurance Company, Associated Indemnity Corporation, and National Surety Corporation. The examination is, in general, a report by exception. Therefore, much of the material reviewed will not be contained in this written report, as reference to any practices, procedures, or files that revealed no concerns were omitted.

## **SCOPE OF EXAMINATION**

This compliance examination commenced on April 1, 2013, and covered the period of January 1, 2011, through December 31, 2011, with analyses of certain operations of the Companies being conducted through April 24, 2014. This action was taken due to previous examination findings referenced in the Market Conduct Report of May 12, 2010.

The examination was arranged and conducted by the Department. It was made in accordance with Market Regulation standards established by the Department and procedures established by the National Association of Insurance Commissioners (NAIC) and accordingly included tests of underwriting practices and terminations.

It is the Department's practice to cite companies in violation of a statute or rule when the results of a sample show errors/noncompliance at or above the following levels: 0 percent for producers who were not appointed and/or licensed and the use of rates that were neither filed with nor approved by the Department; and 10 percent for all other areas reviewed

### **Previous Examination Findings**

A compliance examination covering the period January 1, 2008, through December 31, 2008, was performed on the Companies and a report dated May 12, 2010, was issued. The compliance examination report identified concerns in the areas of underwriting practices and

terminations. Specific previous violations relating to these areas are listed within the appropriate sections of the report.

### **EXECUTIVE SUMMARY**

This market conduct examination revealed concerns with Company procedures and practices in the following areas:

*Underwriting Practices* – Private Passenger Automobile: Recoupment/allocation surcharge was calculated incorrectly and rating errors. Commercial Automobile: Applications accepted from producers not properly appointed, failure to make an individual risk filing, and rating errors.

*Terminations* – Private Passenger Automobile Cancellations: Returned premiums calculated incorrectly.

Specific violations related to each area of concern are noted in the appropriate section of this report. All North Carolina General Statutes and rules of the North Carolina Administrative Code cited in this report may be viewed on the North Carolina Department of Insurance Web site [www.ncdoi.com](http://www.ncdoi.com) by clicking “INSURANCE DIVISIONS” then “Legislative Services.”

This examination identified various non-compliant practices, some of which may extend to other jurisdictions. The Companies are directed to take immediate corrective action to demonstrate their ability and intention to conduct business in North Carolina according to its insurance laws and regulations. When applicable, corrective action for other jurisdictions should be addressed.

All unacceptable or non-compliant practices may not have been discovered or noted in this report. Failure to identify improper or non-compliant business practices in North Carolina or in other jurisdictions does not constitute acceptance of such practices.

## **UNDERWRITING PRACTICES**

### Private Passenger Automobile

The Companies' underwriting practices and procedures for active private passenger automobile policies were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules, policy provisions, and the applicable rules of the Personal Automobile Manual.

**The previous examination revealed the following:**

- The Companies were again deemed to be in violation of the provisions of NCGS 58-37-40(e) and the North Carolina Reinsurance Facility Standard Practices Manual – Section 4 – Rule 10 as they failed to utilize standard undeviated liability premiums in determining the recoupment/allocation surcharge on 66.0 percent of the active private passenger automobile policies reviewed.
- The Companies were again deemed to be in violation of the provisions of NCGS 58-37-40(e) as an incorrect recoupment/allocation surcharge was applied to 100 percent of the active private passenger automobile policies reviewed.
- The Companies were deemed to be in violation of the provisions of NCGS 58-33-40 as 22.0 percent of the private passenger automobile applications reviewed were accepted from a producer who was not appointed.
- The Companies were deemed to be in violation of the provisions of NCGS 58-33-5 and 58-33-26(a) as 10.0 percent of the private passenger automobile applications reviewed were accepted from an individual who was not licensed as a producer in North Carolina.
- The Companies were deemed to be in violation of the provisions of 11 NCAC 19.0102(a), 19.0104, and 19.0106(a)(4) as 34.0 percent of the active private passenger automobile files reviewed did not contain proper file documentation.
- The Companies were again deemed to be in violation of the provisions of NCGS 58-36-30(a) as 36.0 percent of the active private passenger automobile policies reviewed were rated incorrectly.

The Companies provided a listing of 88 active private passenger automobile policies issued during the period under examination. Fifty policies were randomly selected for review.

**The current examination revealed the following:**

- The Companies were again deemed to be in violation of the provisions of NCGS 58-37-40(e) and the North Carolina Reinsurance Facility Standard Practices Manual – Section 4 – Rule 10 as they failed to utilize standard undeviated liability premiums in

determining the recoupment/allocation surcharge on 27 policies reviewed (54.0 percent error ratio).

- The Companies were deemed to be in compliance with the provisions of NCGS 58-37-40(e) as the correct recoupment/allocation surcharge was applied to all active private passenger automobile policies reviewed.
- The Companies were deemed to be in compliance with the provisions of NCGS 58-33-40 as all private passenger automobile applications reviewed were accepted from a producer who was properly appointed by the Companies.
- The Companies were deemed to be in compliance with the provisions of NCGS 58-33-5 and 58-33-26 as all private passenger automobile applications reviewed were accepted from an individual who was licensed as a producer in North Carolina.
- The Companies were again deemed to be in violation of the provisions of NCGS 58-36-30(a) as 43 policies reviewed (86.0 percent error ratio) contained a total of 69 rating errors. The rating errors consisted of the following:
  - Incorrect territory factor was applied to comprehensive and collision coverage on 28 policies.
  - Incorrect physical damage base rates were applied on 21 policies.
  - Safe Driver Incentive Plan (SDIP) point surcharge was calculated incorrectly on five policies.
  - Account credit and multi-car deviations were applied incorrectly on seven policies.
  - Inexperienced operator surcharge should have been applied on two policies.
  - SDIP surcharge should have been applied on one policy.
  - Incorrect physical damage symbol was used to rate two policies.
  - Incorrect class code was applied on one policy.
  - Physical damage premium was calculated incorrectly on one policy.
  - Joint Ownership endorsement was not applied on one policy.

The rating errors resulted in 13 premium overcharges and 30 premium undercharges to the insureds. At the request of the examiners, refunds in the amount of \$2,483.03 were issued by the Companies for the overcharges. The remaining premiums were deemed correct.

As a result of the incorrect physical damage base rates, the examiners requested the Companies conduct a self-audit. The Companies identified 1,331 policies resulting in overcharges in the amount of \$147,887.58. All overcharges were returned to the policyholders prior to the conclusion of the examination.

As a result of the incorrect calculation of the SDIP point surcharge, the examiners requested that the Companies conduct a self-audit. The Companies identified 164 policies resulting in overcharges in the amount of \$101,021.06. All overcharges were returned to the policyholders prior to the conclusion of the examination.

#### Commercial Automobile

The Companies' underwriting practices and procedures for active commercial automobile policies were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules, policy provisions, and the applicable rules of the Commercial Automobile Manual.

#### **The previous examination revealed the following:**

- The Companies were again deemed to be in violation of the provisions of NCGS 58-36-30(a) and Rule 31 of the Commercial Automobile Manual as incorrect rates were used to calculate the premium for non-fleet private passenger automobiles on 66.7 percent of the active commercial automobile policies reviewed.
- The Companies were deemed to be in violation of the provisions of NCGS 58-41-50(b)(f) and Rules 89 and 90 of the Commercial Automobile Manual as incorrect rates were used to calculate the Hired and/or Non-Owned Automobile premiums on all of the active commercial automobile policies reviewed.
- The Companies were deemed to be in violation of the provisions of NCGS 58-33-40 as 33.3 percent of the commercial automobile applications reviewed were accepted from a producer who was not appointed.

The entire population of 15 active commercial automobile policies issued during the period under examination was selected for review. **The current examination revealed the following:**

- The Companies were deemed to be in compliance with the provisions of NCGS 58-41-50(b)(f) and Rules 89 and 90 of the Commercial Automobile Manual as correct

rates were used to calculate the Hired and/or Non-Owned Automobile premiums on all of the policies reviewed.

- The Companies were again deemed to be in violation of the provisions of NCGS 58-33-40 as the producer was not properly appointed by the Companies for seven of the active files reviewed (46.7 percent error ratio).
- The Companies were deemed to be in violation of the provisions of NCGS 58-41-50(b)(f), 11 NCAC 10.0105, and Rule 15 of the North Carolina State Exceptions as they failed to make an individual risk filing for one policy reviewed (6.7 percent error ratio).
- The Companies were deemed to be in violation of the provisions of NCGS 58-41-50(b)(f) as five policies reviewed (33.3 percent error ratio) were rated incorrectly. The rating errors consisted of the following:
  - The Fleetcover endorsement was rated incorrectly for two policies reviewed.
  - The rates used to calculate the Medical Payments coverage for two policies reviewed had not been filed with and approved by the Department.
  - The physical damage coverage was rated incorrectly for one policy reviewed.

The rating errors resulted in one premium overcharge and two premium undercharges to the insureds. The premium for two policies remained unchanged. At the request of the examiners, a refund in the amount of \$12.00 was issued by the Companies for the overcharge. The remaining premiums charged were deemed correct.

## **TERMINATIONS**

### Private Passenger Automobile Cancellations

The Companies' cancellation procedures for private passenger automobile policies were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules, policy provisions, and the applicable rules of the North Carolina Personal Automobile Manual.

#### **The previous examination revealed the following:**

- The Companies were again deemed to be in violation of the provisions of NCGS 20-309.2, NCGS 20-309(e), 11 NCAC 19.0102(a), 19.0104, and 19.0106(a)(4)(h) as 10.0 percent of the cancelled private passenger automobile files reviewed did not contain a copy of the North Carolina Notice of Termination form.

- The Companies were deemed to be in violation of the provisions of NCGS 58-36-30(a) and Rule 10 of the North Carolina Personal Automobile Manual as the return premium was calculated incorrectly on 12.0 percent of the cancelled private passenger automobile policies reviewed.

The Companies provided a listing of 435 private passenger automobile policies that were cancelled during the period under examination. Fifty policies were randomly selected for review. **The current examination revealed the following:**

- The Companies were deemed to be in compliance with the provisions of NCGS 20-309.2, NCGS 20-309(e), 11 NCAC 19.0102(a), 19.0104, and 19.0106(a)(4)(g) as all of the cancelled private passenger automobile files reviewed did contain a copy of the North Carolina Notice of Termination form.
- The Companies were again deemed to be in violation of the provisions of NCGS 58-36-30(a) and Rule 10 of the North Carolina Personal Automobile Manual as the return premium was calculated incorrectly on 12 policies reviewed (24.0 percent error ratio).

The cancellation errors resulted in two understatements and ten overstatements of refund to the insureds. At the request of the examiners, refunds in the amount of \$169.32 were issued by the Companies for the understatements of refund.

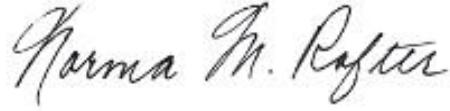
### **CONCLUSION**

An examination has been conducted on the market conduct affairs of Fireman's Fund Insurance Company, American Automobile Insurance Company, The American Insurance Company, Associated Indemnity Corporation, and National Surety Corporation for the period January 1, 2011, through December 31, 2011, with analyses of certain operations of the Companies being conducted through April 24, 2014.

This examination was conducted in accordance with the North Carolina Department of Insurance and the National Association of Insurance Commissioners Market Regulation Handbook procedures, including analyses of Company operations in the areas of underwriting practices and terminations.

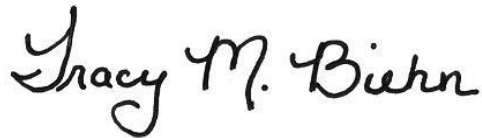
In addition to the undersigned, Kelvin A. Owens and Sharon O'Quinn, North Carolina Market Conduct Examiners, participated in this examination.

Respectfully submitted,

A handwritten signature in cursive script that reads "Norma M. Rafter".

Norma M. Rafter, CPCU  
Examiner-In-Charge  
Market Regulation Division  
State of North Carolina

I have reviewed this examination report and it meets the provisions for such reports prescribed by this Division and the North Carolina Department of Insurance.

A handwritten signature in cursive script that reads "Tracy M. Biehn".

Tracy M. Biehn, LPCS, MBA  
Deputy Commissioner  
Market Regulation Division  
State of North Carolina